

Message Text

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TAGS: ECON, EINV, ELAB, OECD
SUBJECT: ECONOMIC POLICY COMMITTEE/WORKING PARTY 2:
WORK BEGINS ON REVISED AND EXTENDED MEDIUM-TERM SCENARIO
(1977-1985)

REF: (A) DOCUMENTS CPE/WP2(77)4, 5 6, 7;
(B) PARIS 29941

1. SUMMARY: WP-2 LAUNCHED AN AMBITIOUS PROGRAM OF
DEVELOPING A REVISED MEDIUM-TERM SCENARIO TO 1985 WHICH
EPC COULD USE AS A BENCHMARK FOR MONITORING NATIONAL
OBJECTIVES UNDER THE OECD MEDIUM-TERM STRATEGY. THE
DELEGATES COMMENTED ON BOTH TECHNICAL AND POLICY ASPECTS
OF SECRETARIAT PAPERS OUTLINING THE 1985 EMPLOYMENT TAR-
GETS AND INVESTMENT REQUIREMENTS. A MAJOR DISCUSSION OF
INVESTMENT DETERMINANTS DURING THE RECENT RECESSION
POLARIZED INTO ONE CAMP (U.S.) COMPOSED OF THOSE VIEWING
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GROWTH AND DEMAND AS THE PRINCIPAL FACTOR AND A SECOND
(GERMAN, JAPAN, AUSTRALIA) CITING INCOME DISTRIBUTION
(I.E., PROFIT SHARE). THE FEAR OF INFLATION AND A SUB-
SEQUENT NEED FOR SPEED LIMITS ON GROWTH ALSO EVOKED A
LIVELY DEBATE DRAWN GENERALLY ALONG THE SAME COUNTRY
LINES OF THE INVESTMENT DISCUSSION. THE MEETING PRO-
VIDED A USEFUL EXCHANGE OF VIEWS WHICH THE SECRETARIAT

CAN INCORPORATE IN THE DRAFT SCENARIO TO BE DISCUSSED AT THE NEXT MEETING ON MARCH 16/17, 1978. END SUMMARY.

2. WP-2 INITIATED THE IMPROVEMENT AND EXTENSION TO 1985 OF THE MEDIUM-TERM SCENARIO WHICH ORIGINALLY COVERED THE YEARS 1976-80 AND WAS PUBLISHED IN THE "ECONOMIC OUTLOOK" NO. 19. THIS SCENARIO FORMED A QUANTITATIVE ILLUSTRATION FOR THE MEDIUM-TERM STRATEGY WHICH WAS ADOPTED BY THE OECD COUNCIL AT MINISTERIAL LEVEL IN 1976. THE NEW SCENARIO SHOULD HAVE PARTICULAR IMPORTANCE AS IT IS INTENDED TO TRACE A GROWTH PATH AND ASSOCIATED VARIABLES AGAINST WHICH THE EPC COULD EXAMINE THE NATIONAL OBJECTIVES OF MEMBER COUNTRIES, IN THE COURSE OF ITS MONITORING EXERCISE BEGUN IN ITS NOVEMBER 21/22 MEETING. THE SECRETARIAT PAPERS (REF. A AND DISCUSSED BELOW) WERE DESIGNED TO ELICIT REACTIONS FROM THE WORKING PARTY ON THE OVERALL APPROACH TO AND TARGETS FOR THE NEW SCENARIO. IT WAS GENERALLY AGREED THAT THE SCENARIO SHOULD NOT BE ELABORATED IN MINUTE DETAIL (EITHER FOR THE OECD AREA OR INDIVIDUAL COUNTRIES), BUT SHOULD INSTEAD IDENTIFY THOSE CRUCIAL FACTORS WHICH WILL DETERMINE WHETHER OR NOT THE TARGETS FOR 1985 CAN BE MET. THE RESPECTIVE ROLES OF SUPPLY AND DEMAND FACTORS IN OUTLINING THE SCENARIO WAS EXTENSIVELY DISCUSSED, WITH A GREAT DEAL OF SUPPORT BEING EXPRESSED FOR A SUPPLY SIDE APPROACH WHICH WOULD TARGET DIMINISHING UNEMPLOYMENT TO AN IRREDUCIBLE, NON-LIMITED OFFICIAL USE

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INFLATIONARY MINIMUM AT THE END POINT OF THE SCENARIO. SEVERAL COUNTRIES, HOWEVER, EMPHASIZED THE ROLE OF DEMAND, PARTICULARLY WORLD TRADE, IN DETERMINING WHAT LEVEL OF GROWTH WOULD BE FEASIBLE, AS OPPOSED TO THE LEVEL THAT WOULD BE "NECESSARY" UNDER THE SUPPLY APPROACH. DESPITE SUGGESTIONS BY SOME THAT MULTIPLE SCENARIOS BE PRODUCED, IT WAS THE GENERAL VIEW THAT THE WORKING PARTY SHOULD SUBMIT A SINGLE SCENARIO TO EPC HAVING, HOWEVER, LOOKED AT ALTERNATIVES BASED ON DIFFERENT ASSUMPTIONS OF INITIAL CONDITIONS, POTENTIAL LABOR SUPPLY, INVESTMENT DETERMINANTS, INFLATION IMPACT, ETC. SPECIFIC ISSUES DISCUSSED IN THE COURSE OF THE MEETING ARE OUTLINED IN THE SUBSEQUENT PARAGRAPHS.

3. EMPLOYMENT: DRAWING ON EPC/WP2(77)4, THE WORKING PARTY DISCUSSED THE OUTLOOK FOR THE LABOR SUPPLY TO 1985, WITH PARTICULAR EMPHASIS ON DEFINING SOURCES OF UNEMPLOYMENT. THE SECRETARIAT LEXICALLY DIVIDING UNEMPLOYMENT INTO CYCLICAL (DEMAND SHORTAGE), STRUCTURAL (CAPITAL

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SHORTAGE) -- THE DESIGNATION "STRUCTURAL" WAS DROPPED BY THE SECRETARIAT WHICH ADOPTED THE TERM "BOTTLENECK UNEMPLOYMENT" AT THE SUGGESTION OF NORDHAUS, AND FRICTIONAL (ATTRIBUTABLE TO LABOR MARKET INEFFICIENCIES AND SUPPLY/DEMAND MISMATCHES) COMPONENTS WAS FOUND USEFUL. HOWEVER, A CONSENSUS DEVELOPED THAT THE SPOLICY OBJECTIVE SHOULD NOT BE TO ELIMINATE "CYCLICAL" AND "STRUCTURAL," I.E., ACCEPT CURRENT LEVELS OF "FRICTIONAL UNEMPLOYMENT" BUT SHOULD, VIA SELECTIVE EMPLOYMENT AND MICRO POLICIES, ALSO SEEK TO REDUCE THE FRICTIONAL ELEMENTS. U.S. DELEGATE (NORDHAUS) STATED THAT THE UNITED STATES PREFERRED TO USE A CONCEPT OF THE NON-INFLATIONARY RATE OF UNEMPLOYMENT; I.E., A RATE AT WHICH THERE IS NO SIGNIFICANT ACCELERATION IN WAGES. SEVERAL DELEGATIONS, INCLUDING THE UK, CANADA, AUSTRALIA, GERMANY AND JAPAN, PROPOSED THAT THE SECRETARIAT UNEMPLOYMENT TARGETS FOR THEIR COUNTRIES FOR 1985 WERE UNREALISTICALLY AMBITIOUS. OTHER DELEGATES SUGGESTED THAT A MEANINGFUL ANALYSIS OF THE

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POTENTIAL LABOR FORCE MUST INCORPORATE GREATER DISAGGREGATION BY AGE, SEX AND SECTOR, SHOULD MORE EXPLICITLY

ADDRESS THE QUESTION OF WORK TIME AND SHOULD RE-EXAMINE THE SECRETARIAT'S ASSUMPTION THAT THE RISE IN PARTICIPATION RATES WOULD BE SLOWER IN THE FUTURE. THE DANISH DELEGATE SUGGESTED THAT RAPID INCREASES IN LABOR SUPPLY CAN NOT BE QUICKLY ABSORBED AND THEREFORE HIGHER UNEMPLOYMENT DUE TO RAPID SUPPLY INCREASES SHOULD NOT BE COUNTERED BY SHORT-TERM POLICIES.

4. INVESTMENT: ON INVESTMENT REQUIREMENTS OVER THE PERIOD TO 1985 (EPC/WP2(77)5), THE WORKING PARTY FELT THAT THE SECRETARIAT APPROACH WAS OVERLY SIMPLISTIC, PARTICULARLY IN THE USE OF HISTORICAL CAPITAL/OUTPUT RATIOS AS THE BASIS FOR PROJECTING SEVERAL DELEGATES ARGUED THAT NEW FACTORS SUCH AS CONCERN ABOUT THE ENVIRONMENT, ENERGY COSTS, GOVERNMENT POLICIES, SHIFTS IN DEMAND, AND THE RECENT ACCELERATION OF RELATIVE LABOR COSTS, WOULD SUBSTANTIALLY ALTER FUTURE CAPITAL REQUIREMENTS; ALTHOUGH, IN CONFLICTING DIRECTIONS. FOR EXAMPLE THE NETHERLANDS SUGGESTED THAT INDUSTRIALIZED COUNTRIES WOULD, BECAUSE OF THEIR HIGHER INCOME LEVELS, MOVE TO GREATER LEISURE AND MORE QUALITY OF LIFE-ORIENTED PROGRESS, THUS LOWERING CAPITAL NEEDS. THE AUSTRALIAN DELEGATE ON THE OTHER HAND SUGGESTED THAT HIGHER RELATIVE LABOR COSTS WOULD EVOKE MORE CAPITAL INTENSIVE TECHNIQUES RAISING INVESTMENT REQUIREMENTS ABOVE LONGER-TERM TRENDS. THE NORDIC DELS QUESTIONED THE SECRETARIAT ASSUMPTION THAT HOUSING DEMAND WOULD FALL IN THE FUTURE THEREBY RELEASING FUNDS FOR PRODUCTIVE INVESTMENT. THEY SUGGESTED INSTEAD THAT HOUSING DEMAND FOLLOWED ITS OWN CYCLE NOT NECESSARILY TIED EXCLUSIVELY TO DEMOGRAPHIC TRENDS. THE DISCUSSION OF INVESTMENT NEEDS IN LABOR LIMITED OFFICIAL USE

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SURPLUS COUNTRIES FOCUED ON THE FREASIBILITY OF OBTAINING THE REQUIRED HIGHER LEVELS OF INVESTMENT, WITH THE ITALIAN AND GREEK DELEGATES SUGGESTING THAT SUCH INVESTMENT WOULD BE PRINCIPALLY A FUNCTION OF WORLD TRADE AND BALANCE OF PAYMENTS CONSTRAINTS, NOT DOMESTIC MEASURES. THE DISCUSSION OF THIS TOPIC WAS DISAPPOINTING IN THAT TURKEY, PORTUGAL, AND SPAIN DID NOT PARTICIPATE.

5. ON INVESTMENT DETERMINANTS (EPC/WP2(77)6), THE WORK-INT PARTY WAS SPLIT. ON THE ONE HAND WERE THOSE WHO SAW THE GROWTH RATE (E.I., DEMAND FOR OUTPUT) AS THE PRINCIPAL DETERMINANT OF DEMAND, EXPLAINING RECENT POOR INVESTMENT BEHAVIOR BY THE WEAKNESS OF OVERALL GROWTH SINCE 1974. ON THE OTHER HAND WERE THOSE WHO FELT THAT EVEN IF DEMAND WERE SUFFICIENT, RECENT CHANGES IN THE PATTERN OF INCOME DISTRIBUTION AWAY FROM PROFITS AND TOWARDS WAGES WERE THE PRINCIPAL DEPRESSING FACTORS ON

INVESTMENT BEHAVIOR. THE GROWTH HYPOTHESIS WAS PUT FORWARD MOST STRONGLY BY NORDHAUS WHO ARGUED THAT THE RECENT INSUFFICIENCY IN INVESTMENT IN THE UNITED STATES COULD BE EXPLAINED ALMOST ENTIRELY BY A DEARTH OF DEMAND. GERMANY, SWITZERLAND, JAPAN AND AUSTRALIA WERE THE LEADING SPOKESMEN FOR THE POSITION THAT THE NECESSARY PRIVATE INVESTMENT WOULD NOT BE FORTHCOMING UNTIL THE DISTORTIONS IN INCOME DISTRIBUTION WERE CORRECTED. THE SECRETARIAT (DOBELL) SUGGESTED THAT THIS DISCUSSION OUTLINED A SO-CALLED "CATCH 22" SITUATION. THIS IS BECAUSE SOME ARGUED THAT OVERALL GROWTH SUFFICIENTLY RAPID TO CREATE CONFIDENCE AND BRING FORTH THE NECESSARY INVESTMENT WOULD BE INFLATIONARY AND THEREBY ABORTING GROWTH AND INVESTMENT; OTHERS THAT RESTRICTIVE ANTI-INFLATION

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POLICIES REDUCE GROWTH (READ BUSINESS CONFIDENCE) AND STIFLE INVESTMENT, THIS CREATING LONGER-TERM CAPITAL INSUFFICIENCIES AND INSURE FUTURE BOTTLENECKS AND INFLATION. MOST COUNTRIES FELT THAT IT WAS PREFERABLE, IN THE SITUATION LIKELY TO PREVAIL OVER THE TERM OF THE PROJECTED SCENARIO, TO ACCEPT AN INFLATION RISK IN ORDER TO CREATE DEMAND CONDITIONS IN WHICH BUSINESS CONFIDENCE COULD BE RESTORED AND INVESTMENT BROUGHT FORWARD, THIS AVOIDING GENERALIZED LONGER-RUN STRUCTURAL PROBLEMS. THIS MEDICINE WAS PARTICULARLY PRESCRIBED FOR THOSE

COUNTRIES WITH STRONG BOP SITUATIONS AND STABILIZED PRICES.

6. TRADE AND BALANCE OF PAYMENT: VIRTUALLY ALL DELEGATES AGREED THAT THE PATTERN OF WORLD TRADE OVER THE COURSE OF THE SCENARIO WOULD BE A KEY FACTOR IN WHETHER OR NOT THE TARGETS COULD BE MET. HOWEVER, THERE WAS SUBSTANTIAL DISAGREEMENT AS TO WHETHER TRADE WAS AN LIMITED OFFICIAL USE

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ENDOGENOUS VARIABLE SUSCEPTIBLE TO NATIONAL POLICIES OR AN EXOGENOUS FACTOR WHICH HAD TO BE ACCEPTED AS IT EVOLVED. THE LATTER POSITION WAS MOST STRONGLY SUPPORTED BY GERMANY AND JAPAN WITH SUPPORT FROM OTHER SURPLUS COUNTRIES. THE UK DELEGATE ARGUED THAT FUTURE WORLD TRADE COULD NOT BE EXPECTED TO GROW AT PRE-1974 RATE AND THAT THIS FACTOR WOULD SET AN EFFECTIVE SPEED LIMIT (SEE PARAGRAPH 7) ON THE MEDIUM-TERM GROWTH PATTERN. IT WAS AGREED THAT THE SECRETARIAT SHOULD LOOK AT TRADE AND BALANCE OF PAYMENTS FACTORS IN MORE DETAIL FOR THE NEXT MEETING.

7. SPEED LIMITS: THE CONCEPT THAT THE GROWTH PATTERN IN APPROACHING THE 1985 TARGETS MUST BE A SMOOTH, STEADY AND FAIRLY SLOW WAS WIDELY DEBATED IN THE WORKING PARTY. GERMANY AND JAPAN, CITING THE INFLATIONARY DANGERS OF RAPID RECOVERY, STRONGLY SUPPORTED THIS PROPOSITION. THE CONTRARY VIEW, MOST CLEARLY EXPRESSED BY THE U.S. AND SWEDEN, ARGUED THAT THE WORKING PARTY WAS SLIPPING INTO A MODE OF TOO MUCH CAUTION WHICH WOULD VIRTUALLY INSURE FAILURE IN ACHIEVING THE DESIRED TARGETS. THE U.S. DELEGATE PROPOSED THAT THERE WERE NO ABSOLUTE LIMITS ON THE RATE OF GROWTH AND THAT THE SPEED OF THE RECOVERY, IN AND OF ITSELF, WAS NOT A THREAT TO PRICE STABILITY. HOWEVER, HE ADDED THAT THE RECOVERY HAD TO BE CAREFULLY MANAGED SO THAT SUFFICIENT INVESTMENT WOULD BE FORTHCOMING TO EASE THE BOTTLENECKS WHICH COULD ARISE AND TO DIVERT AND PERHAPS RESTRAIN DEMAND WHEN SECTORAL BOTTLENECKS WERE BEING REACHED. SEVERAL DELEGATES NOTED OTHER FACTORS TO BE CONSIDERED IN ASSESSING THE CONCEPT OF SPEED LIMITS, INCLUDING THE INCREASED ATTENTION TO ENVIRONMENT, THE QUALITY OF LIFE, TRENDS IN COMMODITY PRICES AND PRODUCTION POTENTIAL, INTEGRATION LIMITED OFFICIAL USE

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OF LDC INDUSTRIAL PRODUCTION INTO WORLD TRADE, CONTINUED

ADAPTION TO HIGHER ENERGY COSTS.

8. OTHER ITEMS:

(A) THE TIMING OF THE SCENARIO: THE WORKING PARTY AGREED THAT THE WORK ON THE NEW SCENARIO SHOULD BE COMPLETED IN TIME TO PRESENT IT TO THE EPC AT ITS MEETING IN THE SPRING (PROBABLY MAY). ACCORDINGLY, WP-2 AGREED TO REVIEW THE SECRETARIAT'S PROGRESS AT A MEETING ON MARCH 16-17 TO BE FOLLOWED BY A MEETING IN EARLY MAY TO APPROVE THE FINAL SCENARIO. IT IS INTENDED THAT THE SCENARIO WILL BE PASSED BY THE EPC TO THE OECD MINISTERIAL MEETING WHICH IS LIKELY TO MEET BY THE END OF MAY, 1978. SECRETARIAT (DOBELL) SUGGESTED THAT SUCCESSIVE REVISIONS OF THE SCENARIO BECOME AN ANNUAL WP-2 EXERCISE.

(B) THE WORKING PARTY AGREED TO THE PUBLICATION OF THE SECRETARIAT'S SUMMARY PAPER ON TRENDS IN PUBLIC EXPENDITURES WITH ONLY MINOR EDITORIAL CHANGES. NUMEROUS SUGGESTIONS FOR MAJOR WORK WHICH COULD HAVE BEEN INCORPORATED IN THE PAPER, INCLUDING U.S. PROPOSALS TO STUDY THE EFFICIENCY OF PUBLIC EXPENDITURES, USER CHANGES, THE ECONOMIC IMPACT OF GOVERNMENT DEFICITS (AS OPPOSED TO THE POLITICAL AND PSYCHOLOGICAL IMPACT), WERE LEFT FOR POSSIBLE FUTURE WORK. ON A GENERAL POINT, THE WORKING PARTY DID NOT AGREE WITH THE SECRETARIAT'S BYPOTHESIS THAT DEMAND FOR PUBLIC EXPENDITURE WOULD SIGNIFICANTLY DECLINE OVER THE NEXT FEW YEARS, INSTEAD MOST

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MEMBERS SAW AN INCREASED DEMAND FOR SERVICES IN AREAS SUCH AS TRANSPORTATION, ENVIRONMENT AND HOUSING.

(C) SECRETARIAT REQUESTED THAT ALL COUNTRIES WHICH HAD NOT DONE SO SHOULD SUBMIT THE COMPLETED QUESTIONNAIRE (PER REF. B), OR EQUIVALENT DATA IN ANOTHER FORM, BY DECEMBER 22 AT THE LATEST.

(D) THE NEW CHAIRMAN OF WORKING PARTY 2, PER SCHREINER, RAN AN EFFECTIVE MEETING. HAVING SERVED ON WPAW FOR MANY YEARS, HE WAS KNOWLEDGEABLE ON ITS SUBJECT MATTERS, DESPITE THE FACT THAT HE ONLY LEARNED THAT HE WOULD CHAIR THE MEETING WHEN HE WAS ELECTED AS COMPROMISE CANDIDATE BY EPC ON NOVEMBER 22.

(E) THE WORKING PARTY CONSIDERED THE REQUEST FROM TUAC FOR A MORE ACTIVE ROLE IN THE DEVELOPMENT OF THE NEW SCENARIO, GIVEN THEIR DIFFERENCE OF VIEW ON THE THRUST
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OF THE EARLIER VERSION. IT WAS AGREED THAT LIAISON WITH TUAC WOULD BE USEFUL IN DEVISING THE SCENARIO, BUT A DECISION ON THE MODALITIES OF THE LIAISON WAS LEFT FOR THE MARCH MEETING. THE SECRETARIAT BELIEVES THAT AN INFORMAL MEETING WITH TUAC, POSSIBLY THROUGH THE LIAISON COMMITTEE OR AD HOC, ON THE BASIS OF "SANITIZED" SUMMARIES OF THE PROPOSED SCENARIO, BUT BEFORE THE MAY MEETING, WOULD BE USEFUL BOTH TO THE WP AND TO TUAC.

9. COMMENT: MUCY OF THE DISCUSSION AT THE WORKING PARTY, ALTHOUGH FRAMED IN MEDIUM-TERM PARAMETERS, WAS A REPEAT OF THE EXHORTATIONS EXPRESSED DURING THE EPC'S

SHORT-TERM POLICY

DISCUSSION THAT SURPLUS COUNTRIES

SHOULD FULFILL THEIR ROLE AS THE LOCOMOTIVES IN PROVIDING THE IMPETUS NECESSARY TO MOVE THE ENTIRE OECD AREA ALONG A DESIRED GROWTH PATH. AT THE SAME TIME, IT WAS INTERESTING TO NOTE THE SOMEWHAT DEFENSIVE STANCE OF BOTH THE GERMAN AND THE JAPANESE DELEGATIONS IN FACE OF SUGGESTIONS THAT EVEN THEIR LONGER-TERM GROWTH OBJECTIVES SHOULD BE SOMEWHAT HIGHER THAN OFFICIAL GOVERNMENT PROJECTIONS NOW PROVIDE. IN RESPONSE TO A STATEMENT BY THE AUSTRALIAN DELEGATE THAT HE WAS CONFUSED AS TO WHETHER

WP-2 WAS DEBATING THE 1978 OUTLOOK OR THE 1985 SCENARIO,
THE CHAIRMAN QUIPPED THAT WE WOULD NOT REACH SATISFACTORY
OBJECTIVES IN 1985 UNLESS WE DO BETTER IN 1978.
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